

11051 — No. 11059

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA,

Appellant,

vs.

H. F. METCALF, as Trustee in Bankruptcy of the
Estate of F. P. Newport Corporation, Ltd., a corpora-
tion, Bankrupt, and SECURITY FIRST NATIONAL
BANK OF LOS ANGELES,

Appellees.

TRANSCRIPT OF RECORD

Upon Appeal from the District Court of the United States
for the Southern District of California,
Central Division

FILED

AUG 31 1945

PAUL P. O'BRIEN,
CLERK

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INDEX.

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italics; and likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible an omission from the text is indicated by printing in italics the two words between which the omission seems to occur.]

Page

Appeal:

Designation and Stipulation of Contents of Record on	36
Notice of, From Minute Order of March 6, 1945.....	21
Notice of, From Order of April 13, 1945.....	34
Statement of Points on.....	35
Certificate of Clerk.....	39
Designation and Stipulation of Contents of Record on Appeal	36
Findings of Fact, Conclusions of Law and Order of District Judge re Referee's Order of October 17, 1944, Directing Payment of Interest to Security- National Bank of Los Angeles.....	22
Minute Order Entered March 6, 1945.....	20
Minute Order Entered April 13, 1945.....	22
Names and Addresses of Attorneys.....	1
Notice of Appeal From Minute Order of March 6, 1945	21
Notice of Appeal From Order of April 13, 1945.....	34
Order of Referee Authorizing Payment of Interest, etc.	15

	Page
Order to Show Cause re Payment of Interest, etc.....	13
Petition of Trustee for Authority to Pay Interest to Security-First National Bank of Los Angeles Out of Trustee's Special Oil Account etc.....	8
Exhibit A. Statement of Amounts Payable to Se- curity-First National Bank to September 7, 1944	12
Petition of U. S. A. for Review of Referee's Order of October 17, 1944.....	17
Referee's Certificate on Review.....	2
Reporter's Transcript of Proceedings In re: Order to Show Cause, Trustee versus United States of America and Security-First National Bank of Los Angeles	40
Reporter's Transcript of Proceedings on Hearing of Petition for Review of Referee's Order of October 17, 1944	48
Statement of Points on Appeal.....	35
Statement of Points Relied Upon on Appeal (Circuit Court)	67
Stipulation for Consolidation of Appeals From the Orders of the District Court of March 6, and April 13, 1945 (Circuit Court).....	68

NAMES AND ADDRESSES OF ATTORNEYS:

For Appellant:

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United States Attorney,

E. H. MITCHELL,
Assistant U. S. Attorney,

GEORGE M. BRYANT,
Assistant U. S. Attorney,

EUGENE HARPOLE,
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600 U. S. Post Office and Court House Bldg.
Los Angeles 12, Calif.

For Appellee H. F. Metcalf, etc.:

BAILIE, TURNER & LAKE
811 Citizens National Bank Bldg.
Los Angeles 13, Calif.

For Appellee Security First National Bank of Los Angeles:

W. C. SHELTON and
GEORGE W. BURCH, JR.
923 Subway Terminal Bldg.
Los Angeles 13, Calif. [1*]

In the District Court of the United States
Southern District of California
Central Division

In Bankruptcy No. 25308-M

In the Matter of

F. P. NEWPORT CORPORATION, LTD, a corporation,

Bankrupt.

REFEREE'S CERTIFICATE ON REVIEW

To the Honorable Paul J. McCormick, Judge of the
District Court of the United States, Southern District
of California, Central Division:

I, Ernest R. Utley, Referee in Bankruptcy, to whom the
proceedings in this matter were referred, do hereby certify:

1. That on January 12, 1937, F. P. Newport Corporation, Ltd. was duly adjudicated a Bankrupt and proceedings in relation to said bankrupt estate were duly referred to this Referee.

2. That on March 18, 1937, H. F. Metcalf was duly appointed Trustee in Bankruptcy for said Bankrupt Estate, duly qualified as such Trustee, and ever since has been and now is the duly appointed, qualified and acting Trustee in Bankruptcy of said Bankrupt Estate.

3. That subsequent to the adjudication in bankruptcy herein an agreement was entered into between the Security-First National Bank of Los Angeles, the Bankrupt Corporation and said Trustee in Bankruptcy, dated January 12, 1937, which agreement, together with the supplement thereto, dated August 31, 1937, provided that

an indebtedness owing said Bank in excess of \$1,350,000.00 and secured [2] by a Trust covering approximately 90% of all of the property in said Bankrupt Estate, should be payable in installments as follows:

\$ 35,000.00 on or before March 7, 1938;

\$ 65,000.00 on or before September 7, 1938;

\$250,000.00 on or before September 7, 1939;

\$150,000.00 on or before March 7, 1940, and the remaining unpaid principal on or before September 7, 1940.

By the terms of said agreement there was to be paid to said Bank, in addition to the principal of the secured indebtedness above noted, interest at 4% on the unpaid principal, said interest to be payable quarterly on March 7th, June 7th, September 7th, and December 7th of each year.

4. Said agreement and supplement and certain modifications thereof were duly approved by an order made and signed by the Hon. Paul J. McCormick on November 5, 1937, said last-mentioned order was duly affirmed by the United States Circuit Court of Appeals for the Ninth Circuit, and a Petition for Writ of Certiorari was denied by the Supreme Court of the United States.

5. By the terms of the agreement hereinbefore mentioned there became due and payable to said Security-First National Bank of Los Angeles on September 7, 1944, the sum of \$5,534.11, as interest on the principal obligation owing said Bank. That pursuant to the terms and provisions of a Community Oil and Gas Lease entered into by and between the Trustee and the said Bank, as Lessors, and the Bankline Oil Company, as Lessee, the

said Bank received \$229.64, and the further sum of \$40.36 on account of interest collected under the terms of certain contracts of sale covering real property, title to which stood in the name of said Bank as security for said debt, making a total of \$270.00 which, applied on the interest due September 7, 1944, left a balance of \$5,264.00 owing said Bank.

6. That on the 13th day of September, 1944, the Trustee in [3] Bankruptcy filed with this Court his Petition for Authority to Pay to said Bank the balance of the interest hereinbefore mentioned out of the Trustee's Special Oil Account; that on said day an Order to Show Cause was duly issued directed to the United States of America, and Harry C. Westover, as Collector of Internal Revenue, and to Security-First National Bank of Los Angeles, requiring them and each of them to appear before this Court on the 26th day of September, 1944, to show cause, if any or either of them might have, why an order should not be made and entered directing said Trustee to pay said interest out of said funds; that service of said petition and said Order to Show Cause was duly had on the parties therein designated, and the matter came on for hearing on the 26th day of September, 1944, and on said day was duly continued until the 6th day of October, 1944, and on said last-mentioned date said Order to Show Cause and said petition came on regularly for hearing before this Court, Messrs. Bailie, Turner & Lake, by Allen T. Lynch, appearing as Counsel for the Trustee in Bankruptcy, W. C. Shelton, Esq. and George W. Burch, Jr., Esq., appearing as Counsel for the Security-First National

Bank of Los Angeles, and Eugene Harpole appearing for the United States of America and Harry C. Westover, Collector of Internal Revenue. Thereupon it was stipulated in open court that if Mr. Metcalf, the Trustee in Bankruptcy were called he would testify in accordance with the allegations set forth in said petition. No written objections to the payment of said interest out of said funds were filed by the United States of America, and the Court having considered said petition and taking judicial notice of the records and files in this matter contained found and determined that said interest should be paid out of the Trustee's said Special Oil Account, and made and signed its order in accordance therewith on the 17th day of October, 1944.

7. There is now owing and unpaid to said Bank on account of the secured obligation hereinbefore mentioned in excess of \$450,000.00 in principal; that heretofore and on the 31st day of [4] October, 1944, the Referee made an order herein denying without prejudice the petition of the Security-First National Bank of Los Angeles for leave to foreclose under the terms of its Trust, pursuant to which it held title to the bulk of the properties of this estate as security for the money so owing it. By the terms of said order it was provided, among other matters, that the Bank might renew said petition to foreclose at any time on or before June, 1945, if there should be a change in circumstances which would seriously prejudice the interests or security of said Bank. Heretofore interest owing said Bank has been duly paid as it fell due, pursuant to the orders of this Court. Said Bank now

threatens to renew its said petition for leave to foreclose if the interest above mentioned is not paid.

8. The oil funds on deposit in the Trustee's Special Oil Account at the time of the hearing of this matter amounted to approximately \$43,000.00, and the Trustee expected to receive additional royalties which would more than equal the interest above mentioned.

9. That it was and is the opinion of the Referee herein that in the event the Referee's Order heretofore made directing the Trustee to pay out of said oil funds income taxes assessed against the Trustee in Bankruptcy, as such, should become final, then and in that event they would be entitled to no priority in payment over any other expenses of administration, but would be entitled to payment only on a pro rata basis with other expenses of administration, assuming there are insufficient funds to pay all of such expenses. It is further the opinion of the Referee herein that current interest due the Security-First National Bank of Los Angeles under the terms of the agreement hereinbefore mentioned is a proper expense of administration and since there would be in said Oil Account more than sufficient to pay the interest installment above mentioned and the taxes which the Referee has heretofore directed paid to the United States Government, then no prejudice would result to the United States by the payment of [5] said interest.

10. The Trustee is receiving from the oil and gas royalties and deposited in said Special Oil Account between \$5,000.00 and \$6,000.00 each month.

11. Heretofore and within the time allowed by law, the United States of America filed a Petition for Review of the Order hereinbefore mentioned and dated October 17, 1944.

12. The Referee submits herewith the following:

(a) Original Petition of H. F. Metcalf, as Trustee in Bankruptcy, for authority to pay said interest hereinbefore mentioned;

(b) Original Order to Show Cause issued to the United States of America, et al. re the hearing on said Petition and hereinbefore mentioned;

(c) Original Order dated October 17, 1944, and directing payment of said interest;

(d) Original Petition for Review of said Order signed by the United States of America. (Accompanying the Certificate on Review prepared and signed by this Referee and filed with the Court re the review of the Order of June 6, 1944, (affirming which the Court issued a Memorandum Opinion dated January 6, 1945) is a copy of the agreement made and entered into with the Bank, supplement and modifications thereof, heretofore in this Certificate mentioned.); and

(e) Reporter's Transcript.

Dated this 10th day of Feb., 1945.

ERNEST R. UTLEY

Referee in Bankruptcy

[Endorsed]: Filed Feb. 10, 1945. [6]

[Title of District Court and Cause.]

PETITION FOR AUTHORITY TO PAY INTEREST
TO SECURITY-FIRST NATIONAL BANK OF
LOS ANGELES OUT OF TRUSTEE'S SPECIAL
OIL ACCOUNT AND FOR ORDER TO SHOW
CAUSE.

Petitioner, H. F. Metcalf, respectfully represents to the Court:

1. That petitioner is the duly appointed, qualified, and acting Trustee in Bankruptcy herein.

2. That heretofore, by and with the approval of this Court, petitioner, as such Trustee in Bankruptcy, Security-First National Bank of Los Angeles, and the bankrupt, as lessors, made and entered into a certain oil and gas lease with Universal Consolidated Oil Company, as lessee, under and pursuant to the terms and provisions of which certain property of this estate was let to said lessee for the purpose of prospecting for and producing oil and gas therefrom; that a copy of said lease is on file with this Court and the contents thereof are known to the respondents and each of them hereinafter named.

3. That heretofore and on or about January 12, 1937, a certain agreement was made and entered into by and between the Trustee in Bankruptcy herein, said bank, and the bankrupt; that the execution of said agreement, a supplement thereto, and modifications thereof, was [7] duly approved by this Court, and copies thereof are on file with this Court and the contents thereof are known to the respondents and each of them hereinafter named; that in and by said agreement it was provided, among other things, that there should be paid to said bank interest at 4% per annum on the principal balance of the obligation or indebtedness owing to said bank and more particularly

referred to and described in said agreement, said interest being payable quarterly; that it was further provided that income from oil produced or extracted from the properties of the estate, the record title to which was held by said bank as security for the obligation owing it, should be placed in a Special Oil Account, and that the funds therein should be available to the Trustee in Bankruptcy from time to time for the purpose of paying interest, taxes, assessments, and expenses; that the Trustee in Bankruptcy carries at the Head Office of said Security-First National Bank of Los Angeles a Special Oil Account in the name of the Trustee, in which there is deposited from time to time royalties received by the Trustee from Universal Consolidated Oil Company the lease hereinbefore mentioned; that there is presently on deposit in said account the sum of \$37,256.23.

4. That there is now due, owing and unpaid to said bank on account of interest for the quarter ending September 7, 1944, the sum of \$5,534.11; that said Bank has received, under and pursuant to the terms and provisions of a certain oil and gas lease entered into by and between the Trustee and the said bank, as Lessors, and the Bankline Oil Company the additional sum of \$229.64, all as more particularly set forth in Exhibit "A" attached hereto, and by reference made a part hereof; that said bank has likewise received on account of interest collected under the terms of certain conditional sale contracts held by said bank and covering properties of this estate sold on contract, the sum of \$40.36, all as more particularly detailed in said Exhibit "A"; that the total amount so received by said bank as hereinbefore alleged amounts to the sum of \$270.00. [8]

5. That heretofore the United States of America filed in this proceeding a petition wherein it sought an

order directing the Trustee in Bankruptcy herein to pay income taxes in the amount of \$19,362.65; that heretofore upon proceedings duly had before this Court an order was made and signed by the Court on the 6th day of June, 1944, directing the Trustee to pay said taxes out of said Special Oil Account hereinbefore mentioned; that in and by the terms of said order it was provided, among other things, that upon application of said Security-First National Bank of Los Angeles a stay of execution was granted for a period of five days from and after final determination of any review from said order that might be duly prosecuted by said bank; that a petition for review of said order has been duly filed by said Court and the review of said order is now pending and undetermined.

6. That petitioner estimates that on or about the 20th day of September, 1944, he will receive from said Universal Consolidated Oil Company further royalties in the approximate sum of \$5,200.00 for the production for the month of August, 1944; that if said Security-First National Bank of Los Angeles is authorized by this Court to apply the sum of \$270.00 hereinbefore mentioned toward partial liquidation of said interest owing to it as aforesaid then the additional amount necessary to pay said interest in full will be \$5,264.11, and if said sum is paid out of said Special Oil Account the receipt of said royalties for the month of August, 1944, in approximately the same amount will be sufficient to replenish said Special Oil Account.

7. That the total amount of the claim of the United States government hereinbefore mentioned, with interest thereon, is approximately \$25,311.80.

8. That there has been filed and is still pending and undetermined an additional claim of the United States

government for income taxes in the amount of \$35,040.82, which, with interest thereon, amounts to approximately \$40,113.98.

9. That petitioner is uncertain as to whether or not under the [9] circumstances and in view of the pendency of said claims of the United States government and the order hereinbefore made said interest of said bank should not be paid out of said funds.

Wherefore Petitioner prays that an order to show cause be issued by this Court directed to the United States of America and Harry C. Westover, as Collector of Internal Revenue, and to Security-First National Bank of Los Angeles, requiring them and each of them to be and appear before this Court at a time and place to be fixed by the Court, and then and there show cause, if any they or either of them may have, why an order should not be made and signed herein, directing and authorizing the Trustee in Bankruptcy herein to pay to said Security-First National Bank of Los Angeles out of the Trustee's Special Oil Account carried in his name at the Head Office of Security-First National Bank of Los Angeles, Sixth and Spring Streets, Los Angeles, California, the sum of \$5,264.11, with instructions to said bank to use said sum and moneys heretofore received and collected by it to pay interest owing said bank for the quarter ending September 7, 1944, and that upon the hearing of this petition and said order to show cause an appropriate order be made and signed herein.

H. F. METCALF

Trustee in Bankruptcy of F. P. Newport Corporation,
Ltd., a corporation, Petitioner.

BAILIE. TURNER & LAKE

By Allen T. Lynch

Attorneys for Trustee. [10]

EXHIBIT "A"

H. F. METCALF, TRUSTEE IN BANKRUPTCY
FOR F. P. NEWPORT CORPORATION, LTD.Statement of Amounts Payable to Security-First National
Bank to September 7, 1944Interest PaymentInterest on Principal Balance—June 7, 1944
to Sept. 7, 1944 \$5,534.11Deduct, Credits Held by BankOil Royalty Account

June 21, 1944	Bankline Oil	
Company		\$ 81.49
July 20, 1944	Bankline Oil	
Company		80.30
Aug. 21, 1944	Bankline Oil	
Company		67.85

Total Oil Royalty Account \$229.64

Interest Collections

June 7, 1944	Interest	
Collected		\$15.23
July 7, 1944	Interest	
Collected		2.25
Aug. 31, 1944	Interest	
Collected		22.88

Total Interest Collections 40.36

Total Credit to Be Deducted . . 270.00

Net Amount of Check \$5,264.11

[Verified.]

[Endorsed]: Filed Sep. 13, 1944 at 20 Min. Past 10 o'clock A. M. Ernest R. Utley, Referee. R. Clerk.

Received copy of the within this 19 day of Sept., 1944. Charles H. Carr, U. S. Atty., by R. MacKay.

[Endorsed]: Filed Feb. 10, 1945. [12]

[Title of District Court and Cause.]

ORDER TO SHOW CAUSE RE PAYMENT OF
INTEREST DUE SECURITY-FIRST NATION-
AL BANK OF LOS ANGELES

On reading and filing the verified petition of H. F. Metcalf, Trustee in Bankruptcy herein, and good cause appearing therefor,

It Is Hereby Ordered:

1. That the United States of America and Harry C. Westover, as Collector of Internal Revenue, and Security-First National Bank of Los Angeles be and appear before this Court in its court room, 324 Federal Building, Temple and Spring Streets, Los Angeles, California, on the 26th day of September, 1944, at the hour of 10 o'clock A. M. of said day, and then and there show cause, if any they or either of them may have, why an order should not be made and signed herein authorizing and directing the Trustee in Bankruptcy herein to pay to the Security-First National Bank of Los Angeles, out of the Trustee's Special Oil Account, the sum of \$5,264.11, with instructions to said bank to use said sum, and the sum of \$270.00 collected by it as in its said petition alleged, for

the purpose of paying interest owing said bank for the quarter ending September 7, 1944, all as more particularly referred to in said petition.

2. That a copy of this order to show cause and the petition [13] herein referred to be served upon said United States of America and Harry C. Westover, as Collector of Internal Revenue, and upon Security-First National Bank of Los Angeles, by delivering a copy of each said order to show cause and said petition to

Eugene Harpole, Special Attorney, Bureau of
Internal Revenue, or

Charles H. Carr, United States Attorney,
as attorneys for said United States of America and said Collector of Internal Revenue, and by delivering a copy of each said order to show cause and said petition to

W. C. Shelton,
as attorney for said Security-First National Bank of Los Angeles; said service to be made at least five days before the date set for the hearing of this order to show cause by any male citizen of the United States of America over the age of twenty-one years; and that no other or further service of this order to show cause or of said petition need be made.

Dated this 13 day of September, 1944.

BENNO M. BRINK

Referee in Bankruptcy

[Endorsed]: Filed Sep. 13, 1944, at 20 Min. Past 10 o'clock A. M. Ernest R. Utley, Referee. R. Clerk.

[Endorsed]: Filed Feb. 10, 1945. [14]

[Title of District Court and Cause.]

ORDER AUTHORIZING PAYMENT OF INTEREST
TO SECURITY-FIRST NATIONAL BANK OF
LOS ANGELES OUT OF TRUSTEE'S SPECIAL
OIL ACCOUNT.

That on or about September 13, 1944, the Trustee in Bankruptcy herein filed a Petition for Authority to Pay Interest to Security-First National Bank of Los Angeles Out of Trustee's Special Oil Account and for Order to Show Cause thereunder. That on the filing of said petition an order to show cause was issued by this Court, directed to Security-First National Bank of Los Angeles, United States of America and Harry C. Westover, as Collector of Internal Revenue of the United States of America, directing them to appear before this Court in its Court Room, 324 Federal Building, Temple and Spring Streets, Los Angeles, California, on the 26th day of September, 1944, at the hour of 10 o'clock A. M. of said day, and then and there show cause why the relief prayed for in said petition should not be granted. That on said 26th day of September, 1944, at the hour of 10 o'clock A. M., said petition and order to show cause came on regularly before this Court and was then duly and regularly continued until the 5th day of October, 1944; that thereafter and on said last-mentioned date at the hour of 10 o'clock A. M. said order and said petition came on regularly for hearing, Messrs. Bailie, Turner & Lake, by Allen T. Lynch, [15] appearing as counsel for said Trustee in Bankruptcy, W. C. Shelton, Esq., and George W. Burch, Jr., Esq., appearing for the Security-First National Bank of Los Angeles, Eugene Harpole, Esq., appearing as counsel for the United States of America, and Harry C. Westover, as Collector of Internal Revenue,

and no written objections having been filed to said petition, and the Court having heard and considered the argument of counsel, certain stipulations made and entered into in open Court, and said petition, and being fully advised in the premises, and good cause appearing therefor,

It Is Ordered:

1. That H. F. Metcalf, as Trustee in Bankruptcy herein, be and he is hereby authorized and directed to pay to Security-First National Bank of Los Angeles out of the Trustee's Special Oil Account carried in his name as such Trustee in Bankruptcy at the Head Office of said Bank, Sixth and Spring Streets, Los Angeles, California, the sum of \$5,264.11, with instructions to said Bank to use said sum to apply on account of interest due and owing said Bank on September 7, 1944, under the agreement, modifications and supplement thereof described in said petition.

2. That said Security-First National Bank of Los Angeles is directed and ordered to use and apply the sum of \$270.00 heretofore collected by it from the Bankline Oil Company, alleged in Exhibit "A" of said petition, for the purpose of paying the balance of said interest, amounting in all to \$5,534.11.

Dated this 17 day of October, 1944.

ERNEST R. UTLEY

Referee in Bankruptcy

Approved as to Form:

W. C. SHELTON

EUGENE HARPOLE

[Endorsed]: Filed Oct. 17, 1944, at min. past 4 o'clock P. M. Ernest R. Utley, Referee. R. Clerk.

[Endorsed]: Filed Feb. 10, 1945. [16]

[Title of District Court and Cause.]

PETITION FOR REVIEW OF REFEREE'S ORDER
OF OCTOBER 17, 1944

Comes now the United States of America, by and through its attorneys, Charles H. Carr, United States Attorney, E. H. Mitchell, Assistant United States Attorney, George M. Bryant, Assistant United States Attorney, and Eugene Harpole, Special Attorney, Bureau of Internal Revenue, and files this, its Petition for Review of that certain Order made by Referee in Bankruptcy, Ernest R. Utley, Esq., and entered in the above-entitled proceeding on the 17th day of October, 1944, ordering and authorizing H. F. Metcalf as Trustee in Bankruptcy, to pay to the Security-First National Bank of Los Angeles out of the Trustee's special oil account the sum of \$5,264.11 to apply on account of interest due and owing said bank on September 7, 1944, and further directing said Security-First National Bank of Los Angeles to apply the sum of \$270.00 theretofore collected by it from the Bankline Oil Company upon the balance of said interest, the total of said authorized payments amounting to \$5,534.11. Said Order reads as follows, to wit:

"That on or about September 13, 1944, the Trustee in Bankruptcy herein filed a Petition for Authority to Pay Interest to Security-First [17] National Bank of Los Angeles Out of Trustee's Special Oil Account and for Order to Show Cause thereunder. That on the filing of said petition an order to show cause was issued by this Court, directed to Security-First National Bank of Los Angeles, United States of America and Harry C. Westover, as Collector of Internal Revenue of the United States of America, directing them to appear before this Court

in its Court Room, 324 Federal Building, Temple and Spring Streets, Los Angeles, California, on the 26th day of September, 1944, at the hour of 10 o'clock A. M. of said day, and then and there show cause why the relief prayed for in said petition should not be granted. That on said 26th day of September, 1944, at the hour of 10 o'clock A. M., said petition and order to show cause came on regularly before this Court and was then duly and regularly continued until the 6th day of October, 1944; that thereafter and on said last-mentioned date at the hour of 10 o'clock A. M. said order and said petition came on regularly for hearing, Messrs. Bailie, Turner & Lake, by Allen T. Lynch, appearing as counsel for said Trustee in Bankruptcy, W. C. Shelton, Esq. and George W. Burch, Jr., Esq., appearing for the Security-First National Bank of Los Angeles, Eugene Harpole, Esq., appearing as counsel for the United States of America, and Harry C. Westover, as Collector of Internal Revenue, and no written objections having been filed to said petition, and the Court having heard and considered the argument of counsel, certain stipulations made and entered into in open Court, and said petition, and being fully advised in the premises, and good cause appearing therefor,

It Is Ordered:

1. That H. F. Metcalf, as Trustee in Bankruptcy herein, be and he is hereby authorized and directed to pay to Security-First National Bank of Los Angeles out of the Trustee's Special Oil Account carried in his name as such Trustee in Bankruptcy [18] at the Head Office of said Bank, Sixth and Spring Streets, Los Angeles, California, the sum of \$5,264.11.

with instructions to said Bank to use said sum to apply on account of interest due and owing said Bank on September 7, 1944, under the agreement, modifications and supplement thereof described in said petition.

2. That said Security-First National Bank of Los Angeles is directed and ordered to use and apply the sum of \$270.00 heretofore collected by it from the Bankline Oil Company, alleged in Exhibit "A" of said petition, for the purpose of paying the balance of said interest, amounting in all to \$5,534.11.

Dated this 17 day of October, 1944.

s/ ERNEST R. UTLEY
Referee in Bankruptcy

Approved as to Form:

W. C. SHELTON
EUGENE HARPOLE"

In this Petition for a Review, the United States of America alleges that the Referee in Bankruptcy erred in said Order of October 17, 1944, in the following respects:

I.

The Referee in Bankruptcy erred in ordering and directing the Trustee in Bankruptcy to pay or permit to be paid the sum of \$5,534.11 or any other sum whatsoever to the Security-First National Bank of Los Angeles to apply upon interest due and owing said bank upon a debt of the bankrupt, before the income taxes due the United States from the bankrupt estate and its Trustee as such, for 1938, 1939 and subsequent taxable years in amounts shown by the petition upon which said order was based, to presently exceed the sum of \$65,000.00 have been paid in full. [19]

Dated: this 13th day of November, 1944.

CHARLES H. CARR,
United States Attorney

E. H. MITCHELL,
Asst. United States Attorney

GEORGE M. BRYANT,
Asst. United States Attorney

EUGENE HARPOLE
Special Attorney,
Bureau of Internal Revenue.

[Endorsed]: Filed Nov. 14, 1944, at 50 min. past 2 o'clock P. M. Ernest R. Utley, Referee. M. Clerk.

[Endorsed]: Filed Feb. 10, 1945. [20]

[Minutes: Tuesday, March 6, 1945]

Present: The Honorable Claude McColloch, District Judge.

The Petition of the Government filed in the above-entitled matter on November 14, 1944, for Review of Referee's Order of October 17, 1944, having come before the Court on February 26, 1945, for hearing on the petition and Certificate of the Referee, and the same having been argued by counsel and ordered submitted, and the Court having duly considered the same and the arguments of counsel, and being fully advised in the premises as to the facts and the law, now orders that the Order of the Referee herein of October 17, 1944, authorizing payment of interest to Security-First National Bank of Los Angeles out of Trustee's Special Oil Account, be, and the same hereby is, affirmed. Copies to counsel. [21]

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice is hereby given that the United States of America, claimant in the above entitled bankruptcy proceeding, hereby appeals to the Circuit Court of Appeals for the Ninth Circuit from the Order of the United States District Court for the Southern District of California dated March 6, 1945, confirming and approving the Order of Ernest R. Utley, Referee in Bankruptcy, of October 17, 1944, authorizing payment of interest to Security-First National Bank of Los Angeles out of the Trustee's Special Oil Account. The Order hereby appealed from was made and entered in this action through the Honorable Claude McColloch, acting Judge of the above-entitled Court on the 6th day of March, 1945.

Dated: this 4th day of April, 1945.

CHARLES H. CARR,
United States Attorney

E. H. MITCHELL,
Asst. United States Attorney

GEORGE M. BRYANT,
Asst. United States Attorney

EUGENE HARPOLE,
Special Attorney,
Bureau of Internal Revenue

By Eugene Harpole

Attorneys for the United States of America.
Appellant.

[Endorsed]: Filed & mailed copy to Allen T. Lynch and W. C. Shelton, attys. for appellees Apr. 4, 1945. [22]

[Minutes: Friday, April 13, 1945]

Present: The Honorable Paul J. McCormick, District Judge.

It is ordered that Findings of Fact, Conclusions of Law, and Order re Referee's Order of October 17, 1944, directing payment of interest to the Security-First National Bank of Los Angeles, signed at Portland, Oregon, by Judge McColloch, April 9, 1945, be filed and entered, and the same are entered in C. O. B. 32, page 52. [23]

In the District Court of the United States
Southern District of California
Central Division

In Bankruptcy No. 25308-M

In the Matter of

F. P. NEWPORT CORPORATION, LTD., a Corporation,

Bankrupt.

FINDINGS OF FACT, CONCLUSIONS OF LAW,
AND ORDER RE REFEREE'S ORDER OF OCTOBER 17, 1944, DIRECTING PAYMENT OF INTEREST TO SECURITY-FIRST NATIONAL BANK OF LOS ANGELES.

Be It Remembered: That heretofore, and on the 26th day of February, 1944, at the hour of 2 o'clock P. M. there came on regularly for hearing before the Honorable Claude McColloch, Judge of the above-entitled Court, the Petition for Review of the Order of the Honorable Ernest R. Utley, Referee in Bankruptcy, made and signed in the above-entitled bankruptcy proceedings on the 17th day of

October, 1944, directing the payment to Security-First National Bank of Los Angeles of interest due and owing said Bank in the sum of \$5,534.11, Messrs. Bailie, Turner & Lake appearing as counsel for the Trustee in Bankruptcy, W. C. Shelton, Esq. appearing as counsel for the Security-First National Bank of Los Angeles, and Eugene Harpole, Esq., appearing as counsel for the United States of America; and the Court having considered said Petition, the Referee's Certificate on Review, the Memoranda of Points and Authorities on file, the argument of counsel and the matter having been submitted for decision, and being fully advised in the premises, the court finds:

Findings of Fact [24]

I.

That on January 12, 1937, the above-named corporation was adjudicated a bankrupt and proceedings in relation to said bankrupt estate were duly referred to the Honorable Ernest R. Utley, as Referee in Bankruptcy.

II.

That on March 18, 1937, H. F. Metcalf was duly appointed Trustee in Bankruptcy of said bankrupt estate, thereafter qualified as such Trustee, ever since has been and now is the duly appointed, qualified and acting Trustee in Bankruptcy of said estate.

III.

That at the time of the adjudication in bankruptcy herein the Security-First National Bank of Los Angeles held the record legal title to approximately 90% of the real properties of this bankrupt estate, as Trustee under its Trust No. D-7224, and as security for an indebtedness owing said Bank by said bankrupt corporation in excess of \$1,350,000.00. The whole of said indebtedness at the date of said adjudication having been long past due.

IV.

That the Trustee in Bankruptcy, the bankrupt corporation, and said Security-First National Bank of Los Angeles made and entered into an agreement in writing dated January 12, 1937, which agreement, together with a supplement and certain modifications thereof, were duly approved by this Court and the United States Circuit Court of Appeals for the Ninth Circuit.

V.

That said Agreement, among other things, provided that the indebtedness owing said Bank should be paid in installments as follows:

- \$35,000 on or before March 7, 1938;
- \$65,000 on or before September 7, 1938;
- \$250,000 on or before September 7, 1939;
- \$150,000 on or before March 7, 1940. [25]
- and the remainder on or before September 7, 1940.

It was further provided by said agreement, as supplemented and modified, that interest should be paid on the unpaid principal of said indebtedness at the rate of 4% per annum, payable quarterly on March 7th, June 7th, September 7th and December 7th of each year, and

“The first installment of said interest thereon shall be paid on or before March 7, 1938. Thereafter said interest shall be paid quarterly from March 7, 1938. If any installment of interest be not so paid, it shall bear like interest as the principal.”

Said agreement further provides that:

VI.

“So long as all of the terms and conditions of this agreement are complied with by the other parties here-

to, the Bank agrees not to foreclose the security held for the payment of said indebtedness.

"It is distinctly understood and agreed, however, that should any installment of principal or interest be not paid as herein provided, or any taxes or assessments, be not paid ten days prior to the delinquency thereof, or any of the terms and conditions of this agreement and the Declaration of Trust, herein referred to, be not complied with in the manner and at the times herein, and in said Declaration of Trust provided, that the Bank, except as otherwise provided for herein, may at its option call immediately due and payable the entire amount of the indebtedness then owing by the Bankrupt, or the Bankrupt Estate, and may immediately foreclose the security held by it, by such procedure as is provided for in said Declaration of Trust, or may foreclose the same by an action in court; provided, however, that the Bank expressly waives the right to foreclose the beneficial interest in said Trust as a pledge, as provided for in said Declaration of Trust, and also waives the provision of said [26] trust contained on page 12 commencing in line 23 with the word 'or' and up to and including the word 'code' in line 27. Notwithstanding anything to the contrary herein contained, it is agreed that the Bankrupt, or the Trustee in Bankruptcy shall have sixty (60) days after written notice within which to remedy any default for which notice has been given, before the Bank shall have the right to accelerate deferred payments of said indebtedness, and commence foreclosure of said security. The said sixty day notice herein provided for, shall be deemed the sixty day notice provided for in said declaration of Trust.

"Waiver of Statute of Limitations.

"In consideration of the execution of this agreement, the Bankrupt, the Receiver and the Trustee, when appointed, qualified, and upon becoming a party hereto, expressly waive the provisions of any statute limiting the time when any action may be brought by the Bank on the indebtedness hereinabove referred to, or hereinafter incurred pursuant to the terms of this agreement and/or the Trust herein referred to.

"Waiver of Defenses in Foreclosure.

"It is understood that one of the principal considerations moving to the Bank in this agreement is the willingness of the other parties hereto to waive any and all defenses they may claim to have to the foreclosure of the security held by the Bank, other than as to the correct amount claimed to be due the Bank. It is, therefore, expressly agreed that, provided the debt be then due, as provided for herein, in any foreclosure proceeding brought pursuant to the terms of said Declaration of Trust, and/or this agreement, no defense thereto will be made, other than to determine the correct amount remaining due and [27] unpaid from the Bankrupt to the Bank, at the time of said foreclosure. And it is expressly agreed that the parties hereto will not seek to enjoin or delay such foreclosure, if and when brought by the Bank."

VII.

That subsequent to the making of said agreement of January 12, 1937, a certain oil and gas lease was made and entered into by the Trustee in Bankruptcy, the Security-First National Bank of Los Angeles, and the Bankrupt, as Lessors, and the Universal Consolidated Oil Company, as Lessee, under and pursuant to the terms and

provisions of which certain property of the Bankrupt, title to which was held by Security-First National Bank of Los Angeles, as heretofore set forth, was leased to said Lessee for the production of oil and gas; that thereafter said Lessee discovered oil upon said premises and has been producing oil and gas therefrom and paying to the Trustee in Bankruptcy herein royalties on account thereof.

VIII.

That the agreement of January 12, 1937, hereinabove mentioned provided, among other things, as follows:

"All income from oil, in the nature of bonuses, rentals and royalties from any of the properties held by the Bank in trust, so paid to the Bank, shall be placed in a Special Oil Account.

"The funds in said account shall be available to the Trustee in Bankruptcy for the purpose of making up any deficiency in the 'Special Fund' to pay interest, taxes, assessments and expenses * * *"

By certain modifications to said agreement, it was provided that the payment on account of oil royalties and bonuses instead of being made direct to the Bank should be made to the Trustee in Bankruptcy and by him deposited in a special account, carried in his name at the Head [28] Office of said Bank, all subject to the following provisions of said agreement, to wit:

"While the said Declaration of Trust No. D 7224 and the contract of January 12, 1937, provide expressly that all moneys from Sales and Leases of Property in said Trust shall be paid to and be received by the Bank, it is, nevertheless, agreed, in order to comply with the bankruptcy law requiring

that all bankruptcy funds be accounted for by the Trustee and be disbursed by him only upon checks or warrants countersigned by the Referee, that all such moneys shall be paid to said Trustee in Bankruptcy, and, until the indebtedness due the Bank has been paid, shall be by him forthwith paid over in full to the Bank, to be distributed in accordance with the terms of said Trust No. D 7224 and the agreement of January 12, 1937, as modified hereby.

"Recognizing that the Bank has a prior right to the moneys in the preceding paragraph mentioned until the indebtedness due it has been paid, it is therefore expressly understood and agreed that such funds or moneys so paid to and received by the said Trustee in Bankruptcy from Sales or Leases or other disposition of property under said Trust shall, until the indebtedness due the Bank has been paid and except as hereinafter provided, be, while in his possession, impressed with the lien of the Declaration of Trust securing the indebtedness owing to the Bank, and such funds or moneys shall be deposited by the [29] Trustee in Bankruptcy in a separate bank account and not commingled with any other funds of the Bankrupt Estate, and shall be deemed earmarked for application on the Bank's indebtedness as provided in said agreement of January 12, 1937, and this supplement thereto, and except as in said agreement and said supplement provided, shall not, until the indebtedness due the Bank has been paid, become any part of the general assets of the Bankrupt Estate."

IX.

Pursuant to the provisions of said agreement of January 12, 1937, as so supplemented and modified, a special

account was opened in the name of the Trustee in Bankruptcy at the Head Office of said Bank and from time to time thereafter said Trustee deposited in said Special Account oil and gas royalties and bonuses received from the Universal Consolidated Oil Company under the terms of the oil and gas lease hereinbefore mentioned, and from time to time thereafter and pursuant to the order and direction of the Court the Trustee paid out of said Special Account interest owing and payable to the Security-First National Bank of Los Angeles and real property taxes assessed against the properties by the City of Long Beach, City of Los Angeles, County of Los Angeles, and State of California.

X.

That subsequent to the year 1939, the Collector of Internal Revenue at Los Angeles, California, filed with the Referee in Bankruptcy for and on behalf of the United States of America a claim in [30] the sum of \$19,363.65 as and for alleged income taxes claimed to be due and owing the United States by the Trustee in Bankruptcy for the years 1938 and 1939. That objections thereto were filed by the Trustee in Bankruptcy and the Claim of the United States was denied by the Referee in Bankruptcy and the order of the Referee in Bankruptcy was duly affirmed by the Honorable Paul J. McCormick, Judge of the above-entitled Court. That thereafter an appeal was taken to the Circuit Court of Appeals, Ninth Circuit, and the order of the Referee was reversed and the Trustee was directed to pay said income taxes.

XI.

That thereafter a petition was filed by the United States of America with the Referee in Bankruptcy and an order to show cause issued thereon, directing the Trustee and

the Security-First National Bank of Los Angeles to show cause, if any they had, why an order should not be made directing the Trustee to pay said income taxes out of said Special Account hereinbefore mentioned; that objections thereto were filed by the Security-First National Bank of Los Angeles who asserted that it had a first and prior lien and claim to said funds under the provisions of said agreement of January 12, 1937 and the terms of its said Trust. That thereafter an order was made by said Referee in Bankruptcy, directing said Trustee to pay said income taxes out of said special account and said order was affirmed by the Honorable Paul J. McCormick. That there is now pending before the Ninth Circuit Court of Appeals an appeal from said order, and said appeal has not yet been heard and determined.

XII.

That additional claims have been filed by the United States of America, through the Collector of Internal Revenue at Los Angeles for asserted income taxes claimed to be owing by the Trustee in Bankruptcy for the years 1940, 1941 and 1942, aggregating in all, with interest, approximately \$40,113.98. That the Court has not heard or considered said claims and no order approving the same has been made [31] in these proceedings.

XIII.

That on September 7, 1944, there became due and payable under the terms of the agreement of January 12, 1937, interest to the Security-First National Bank of Los Angeles in the sum of \$5,534.11, and a petition was filed by the Trustee in Bankruptcy with the referee in Bankruptcy requesting instructions as to whether or not said interest should be paid out of the Special Account hereinbefore mentioned. That an order to show cause was

issued thereon, directed to the United States of America, Harry C. Westover, as Collector of Internal Revenue, and Security-First National Bank of Los Angeles, requesting them and each of them to show cause, if any they had, why an order should not be made and signed authorizing and directing the Trustee in Bankruptcy to pay said interest out of said Special Oil Account. Upon a hearing had before the Referee thereon, an order was made on October 17, 1944, directing the Trustee to pay out of said Special Account on account of said interest the sum of \$5,264.00, the Bank having in its possession other funds in the amount of \$270.11 which could be applied on said interest.

XIV.

That at the time said order was made directing the payment of said interest there was on deposit in said Special Account the sum of \$37,256.23, and at the time of the hearing of the petition on review herein in this Court, there was on deposit in said account approximately \$56,000.00.

XV.

The Trustee is receiving on account of said oil and gas royalties, and depositing in said Special Account, from \$4,000.00 to \$5,000.00 a month. From the Findings of Fact the Court concludes:

Conclusions of Law [32]

I.

That the obligation of the Trustee in Bankruptcy to pay, out of the funds of this bankrupt estate, interest on the secured indebtedness of said Security-First National Bank of Los Angeles was one undertaken by and with the approval of the Court and in order to secure time

within which to liquidate the properties held under the Trust of said Bank and as part of the consideration to said Bank to forgo the right to immediate payment of its entire indebtedness. That said obligation to pay said interest is a part of the cost of administering this estate.

II.

That under the terms of the agreement of January 12, 1937, as supplemented and modified, payment of said interest may be made out of the funds in the Trustee's Special Account carried at the Head Office of said Bank.

III.

That failure to pay said interest when due would jeopardize this entire estate, for if, by reason of the failure to pay said interest, the Court should grant leave to the Bank to foreclose then this property would be lost to this estate.

IV.

That the payment of said interest to said Bank will not jeopardize or prejudice the United States, as there is on deposit in said Special Account more than sufficient funds to pay said interest and the allowed claims of the United States.

V.

That the payment of interest owing said Bank is for the benefit of the estate and will benefit the United States of America in that it is necessary in order to preserve for said estate the property and the oil and gas income from said royalties.

Order [33]

Now, Therefore, Good Cause Appearing, It Is Ordered:

That the order of the Referee in Bankruptcy, dated October 17, 1944, directing payment of interest to Security-First National Bank of Los Angeles be, and the same is hereby confirmed and approved.

Dated this 9th day of April, 1945.

CLAUDE McCOLLOCH

District Judge.

Approved as to Form:

W. C. SHELTON

Attorney for Security-First National Bank of
Los Angeles

CHARLES H. CARR E. H.

United States Attorney

EUGENE HARPOLE

Special Attorney

Attorney for United States of America.

Judgment entered Apr. 13, 1945. Docketed Apr. 13, 1945, C. O. Book 32, Page 52, Edmund L. Smith, Clerk, by E. N. Frankenger, Deputy.

Notation made in Bankruptcy Docket on April 13, 1945, pursuant to Rule 79(a), Civil Rules of Procedure. E. N. Frankenger, Deputy Clerk.

[Endorsed]: Filed Apr. 13, 1945. [34]

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice is hereby given that the United States of America, claimant in the above entitled bankruptcy proceeding, hereby appeals to the Circuit Court of Appeals for the Ninth Circuit from the Order of the United States District Court for the Southern District of California dated April 9, 1945, confirming and approving the Order of Ernest R. Utley. Referee in Bankruptcy, of October 17, 1944, authorizing payment of interest to Security-First National Bank of Los Angeles out of the Trustee's Special Oil Account. The Order hereby appealed from was made and entered in this action through the Honorable Claude McColloch, acting Judge of the above entitled Court on the 9th day of April, 1945.

Dated: this 20th day of April, 1945.

CHARLES H. CARR,
United States Attorney

E. H. MITCHELL,
Asst. United States Attorney

GEORGE M. BRYANT,
Asst. United States Attorney

EUGENE HARPOLE,
Special Attorney,

Bureau of Internal Revenue

By Eugene Harpole

Attorneys for the United States of America,
Appellant.

[Endorsed]: Filed & Mailed Copies to Allen T. Lynch
and W. C. Shelton, Attys. for Appellees May 2, 1945. [35]

[Title of District Court and Cause.]

STATEMENT OF POINTS UPON WHICH APPELLANT, UNITED STATES OF AMERICA, INTENDS TO RELY ON APPEAL

The Appellant, United States of America, designates the following points upon which it intends to rely in its appeal from the Orders of the District Court made and entered in the above entitled proceeding on March 6, 1945 and April 9, 1945, confirming and approving the Referee's Order of October 17, 1944, which directed a payment of interest to Security-First National Bank of Los Angeles by the trustee:

I.

The Referee in Bankruptcy erred in ordering and directing the Trustee in Bankruptcy to pay or permit to be paid the sum of \$5,534.11 or any other sum whatsoever to the Security-First National Bank of Los Angeles to apply upon interest due and owing said bank upon a debt of the bankrupt, before the income taxes due the United States from the bankrupt estate and its Trustee as such, for 1938, 1939 and subsequent taxable years in amounts shown by the petition upon which said order was based. to presently exceed the sum of \$65,000.00 have been paid in full. [36]

Dated: this 26th day of April, 1945.

CHARLES H. CARR.

United States Attorney

E. H. MITCHELL

Asst. United States Attorney

GEORGE M. BRYANT,

Asst. United States Attorney

EUGENE HARPOLE

Special Attorney

Bureau of Internal Revenue

Attorneys for Appellant.

Received copy of the within Statement this 27 day of April, 1945. Bailie, Turner & Lake, *Attorney* for H. F. Metcalf, Trustee.

May 3rd, 1945 Rec'd. copy. W. C. Shelton & Geo. W. Burch, Jr., by W. C. Shelton, Attys. for Security-First National Bank of Los Angeles.

[Endorsed]: Filed May 7, 1945. [37]

[Title of District Court and Cause.]

DESIGNATION AND STIPULATION OF
CONTENTS OF RECORD ON APPEAL

To the Clerk of the District Court of the United States
for the Southern District of California, Central Division:

The Appellant, United States of America, a claimant in the above entitled proceeding, hereby designates the following portions of the record, proceedings and evidence to be contained in the record on its appeal from the Orders entered in the above entitled proceeding on March 6, 1945 and April 9, 1945, by the District Judge, confirming and approving the Referee's Order of October 17, 1944, which directed a payment of interest to the Security-First National Bank of Los Angeles by the Trustee in the above entitled proceeding.

1. Minute Order of March 6, 1945;
2. Notice of Appeal from Minute Order of March 6, 1945;

3. Order of April 9, 1945;
4. Notice of Appeal from Order of April 9, 1945;
5. Referee's Certificate on Review dated February 10, 1945;
6. Petition for Review of Referee's Order of October 17, 1944;
7. Referee's Order of October 17, 1944; [38]
8. Referee's Order to Show Cause of September 13, 1944;
9. Trustee's Petition of September 12, 1944;
10. Reporter's Transcript of Proceedings of October 5, 1944;
11. Contents of Record on Appeal taken by Security-First National Bank of Los Angeles from the Order of the above entitled Court entered in this proceeding on February 6, 1945, which confirmed the Referee's Order of June 6, 1944; (by reference)
12. Appellant's Statement of Points upon which it intends to rely upon Appeal;
13. Clerk's Certificate;
14. This Designation of Contents of Record on Appeal and the appended Stipulation of Approval.
15. Reporter's Transcript of proceedings had before Hon. Claude McColloch on February 26, 1945.

Dated: this 2nd day of May, 1945.

CHARLES H. CARR,

United States Attorney

E. H. MITCHELL,

Asst. United States Attorney

GEORGE M. BRYANT,

Asst. United States Attorney

EUGENE HARPOLE

Special Attorney,

Bureau of Internal Revenue

Attorneys for Appellant. [39]

It is hereby stipulated and agreed by and between counsel for the Appellant and the Appellees that the foregoing designated parts of the record shall constitute the record in the appeal of the United States of America from the Orders entered in the above entitled proceeding on March 6, 1945 and April 9, 1945, by the District Judge, confirming and approving the Referee's Order of October 17, 1944, which directed a payment of interest to Security-First National Bank of Los Angeles by the Trustee.

Dated: this 2nd day of May, 1945.

CHARLES H. CARR,

United States Attorney

E. H. MITCHELL,

Asst. United States Attorney

GEORGE M. BRYANT,

Asst. United States Attorney

EUGENE HARPOLE,

Special Attorney,

Bureau of Internal Revenue

Attorneys for Appellant.

W. C. SHELTON and

GEORGE W. BURCH, JR.,

By W. C. Shelton

Attorneys for Appellee, Security-First National
Bank of Los Angeles.

BAILIE, TURNER & LAKE

By Allen T. Lynch

Attorneys for Appellee, Trustee in Bankruptcy.

[Endorsed]: Filed May 7, 1945. [40]

[Title of District Court and Cause.]

CERTIFICATE OF CLERK

I, Edmund L. Smith, Clerk of the District Court of the United States for the Southern District of California, do hereby certify that the foregoing pages numbered from 1 to 40 inclusive contain full, true and correct copies of Referee's Certificate on Review; Petition for Authority to Pay Interest to Security-First National Bank of Los Angeles out of Trustee's Special Oil Account and for Order to Show Cause; Order to Show Cause re Payment of Interest Due Security-First National Bank of Los Angeles; Order Authorizing Payment of Interest to Security-First National Bank of Los Angeles out of Trustee's Special Oil Account; Petition for Review of Referee's Order of October 17, 1944; Minute Order Entered March 6, 1945; Notice of Appeal; Minute Order Entered April 14, 1945; Findings of Fact, Conclusions of Law and Order re Referee's Order of October 17, 1944, Directing Payment of Interest to Security-First National Bank of Los Angeles; Notice of Appeal; Statement of Points Upon Which Appellant, United States of America, Intends to Rely on Appeal; and Designation and Stipulation of Contents of Record on Appeal, which, together with copy of Reporter's Transcripts of Hearings October 5, 1944 and February 26, 1945, transmitted herewith, and together with Transcript of Record on the Appeal of Security-First National Bank of Los Angeles being No. 11051 in the United States Circuit Court of Appeals for the Ninth Circuit constitute the record on appeal to the United States Circuit Court of Appeals for the Ninth Circuit.

Witness my hand and the seal of said District Court
this 11 day of May, 1945.

[Seal]

EDMUND L. SMITH,
Clerk,

By Theodore Hocke
Chief Deputy Clerk.

[Title of District Court and Cause.]

Before Hon. Ernest R. Utley—Referee

REPORTER'S TRANSCRIPT OF PROCEEDINGS
IN RE: ORDER TO SHOW CAUSE, TRUSTEE
VERSUS UNITED STATES OF AMERICA
AND SECURITY-FIRST NATIONAL BANK
OF LOS ANGELES

Los Angeles, California, Thursday, October 5, 1944.

10:00 o'clock A. M. Session.

The Referee: F. P. Newport.

Mr. Lynch: Ready. This question presents a tax problem. A petition for order to show cause and order to show cause has been directed to the Security-First National Bank and the United States Government and we request the Court's instructions as to whether or not the interest that is due the Security-First National Bank or was due the Security-First National Bank on September 7 amounting to \$5,534.11 should be paid out of the impounded oil funds. The bank has received, as I set up in the exhibit attached to the petition, \$229.64 from the sources indicated therein which is available to apply on that interest. Then the balance of the amount necessary

to pay the interest would have to come out of the oil fund.

The Referee: How much is on hand now in the oil fund?

Mr. Lynch: We have as of the date of the filing of this petition \$37,256.23. Since that time we have received a check from the royalties of approximately \$5200 so there is at the present time approximately \$43,500 in that account.

The Referee: The allowed claim of the government is how much?

Mr. Lynch: The allowed claim with the interest is [2*] approximately \$25,311.60. Now, in addition to that there is on file an additional claim which after crediting the amount that the government has allowed for the year 1942 as an over-assessment amounts to \$35,040.82 and interest on that will bring it up to approximately \$40,113.90 so that we have a total of approximately \$65,000 without taking into consideration the year 1943 and the year 1944, the current year. For 1943 the present indication is that we will have a substantial tax but assuming, without in anywise conceding we are liable for tax on the question of a sale of real property then our tax for the current year 1944 will be substantially, or approximately, \$30,000 so at the present time we face the possibility we will have \$100,000 in round figures of taxes to pay.

The Referee: What is the oil check per month now?

Mr. Lynch: This month, for the month of September, I think it is around between fifty-two and fifty-three hundred dollars.

*Page number appearing at top of Reporter's Transcript.

The Referee: What is the amount of interest to be paid now?

Mr. Lynch: \$5,534.11. There is \$229.64 collected from oil lands.

The Referee: Well, in order to reserve the amount necessary to take care of the tax claims of some \$25,000 and pay interest it would still leave about \$10,000 in the oil fund? [3]

Mr. Lynch: Yes.

The Referee: And then the monthly receipts are about \$5,000 a month?

Mr. Lynch: Yes, but the Court must take into consideration that so far as we are personally concerned we have been allowed all of the credit we are entitled to be allowed for the tax years 1940, 1941 and 1942. In other words, it can be probably safely assumed we have a tax liability for those years of \$40,000.

Mr. Harpole: If the Court please, it seems to me—and I have not had a response from Washington and this is simply my own views—that the tax matter is not in too healthy a position. Here is a corporation,—it is really the Trustee in Bankruptcy that owes the United States here and now sixty-five or sixty-six thousand dollars and some odd in taxes and probably owes another \$30,000 from the end of 1944, or roughly, \$100,000. Against that he has \$37,256 in reserve or the oil or the sinking fund and I do not acquiesce in the view that the United States is confined to the oil fund for the collection of its taxes; however, it is not necessary to have a controversy on that now but these are expenses of administration and not claims in the sense they were debts due when bankruptcy accrued. Taxes have accrued because of a successful and profitable operation of the property by the Trustee in Bankruptcy and with the consent of the principal creditor.

I think that the [4] government interests are jeopardized by continuing to pay interest which after all is a debt that ought to be subordinated to expenses of administration.

Mr. Lynch: No. I think we ought to understand one another on that right here. This is current interest and in any event would be expenses of administration and entitled to the same status of priority that the government claim has. The government claim has no greater sanctity than this claim for current interest.

Mr. Harpole: Well, I am not too well informed on that but the best that would give would be a prorata on the interest. Perhaps it is not good for the estate either to let these taxes go. As I recall, there is a considerable penalty runs on a tax that is not paid after it is due. That can be avoided by paying it.

Mr. Lynch: We would be delighted to pay it if we could just get the bank to say it should be paid.

Mr. Harpole: I think when there is only \$37,000 in sight against a probable \$100,000 liability that the bank ought not to be receiving its interest payment in full and no payment being made on the tax, but that the fund should at least be accumulated until we know as a matter of law how the bank comes out in this case.

The Referee: Of course, on the allowed claim the Court has impounded sufficient money to take care of that. Do you contemplate filing objections on the other claims? [5]

Mr. Lynch: Not on the 1940, '41 and '42 taxes. I think I have indicated heretofore we have found ourselves in somewhat of a peculiar situation with reference to determining what should be done on these taxes. If we are not liable for a tax on a sale, a gain on a sale then certainly we are not entitled to any credit for any loss on the sale. We cannot take the benefit of a loss on a

sale and at the same time say we are not liable for any taxes on a gain. It is either whole hog or none. If we are not liable we are not entitled to any credit. As far as we have been able to figure out so far on the 1940, '41 and '42 taxes if we take the position we are not liable for the gains then we would lose the benefit of the losses, and the loss for those sales that have been for less than the cost would more than offset the gain so at the moment we do not see that we are in any position to file any objection to taxes for those particular years, but that brings up the question whether or not we are going to be estopped if we do not have substantial gains that appear to be facing us for the year 1944, so we have to go back and review the whole history of all the taxes for all the years to determine how we are going to come out and whether it will profit us to take one horn of this dilemma or the other.

The Referee: This is certain. The bank is now reviewing the Court's order directing this claim for taxes in the sum [6] of some \$25,000 plus to be paid.

Mr. Lynch: Yes.

The Referee: The Security-First National Bank is reviewing from that order. Incidentally, Mr. Harpole, I tried to get you day before yesterday to look over a copy of the proposed certificate of review which is in the office, and if you will call for the copy you can see if there is any additional information you want in there. I think it covers everything but you better see it before it is filed. Miss Morris will give you a copy, and you can tell her I said to do so.

Here is the situation: The Court has held and the evidence clearly shows that the oil property and the land on which the oil wells are located is easily worth in excess of a half a million dollars. I do not think the gov-

ernment's claim is going to be jeopardized because certainly if they can take the money from the oil to pay taxes they can take money derived from the sale of the oil lands and properties to pay them. If my decision is sustained I think the government is secured in that respect and the Court can see little need of holding money to pay for the government claim when it is apparent the bank is going to review it, and has reviewed one already, so I think we better pay this interest and get that behind us, and I think everybody is amply protected by the value of the oil property on the tax situation and I think the money will be [7] available to pay the taxes as soon as they are definitely determined. I do not think there is any question about that. If I felt otherwise I would be reluctant to pay this interest but I do not believe there will be any trouble.

Mr. Lynch: Of course, it should be brought out, too, so the record will be clear, we do not get any interest on this fund we have on deposit.

The Referee: That is right. Undoubtedly the question which is now pending on review will probably go to the Supreme Court and there will be considerable time before any money can be used for taxes, and in the meantime the oil fund will be accumulating.

Mr. Harpole: That is true but while the oil fund is accumulating the taxes are accumulating. I don't know what bracket they are in, but I would suppose half of the income from that oil would be written off for current taxes.

Mr. Lynch: No, it is not quite that high but it is pretty high.

The Referee: There is a lot of oil there yet and the property alone,—the bank itself valued the property alone outside of the oil interests at over \$200,000. That is the

bank's figure alone when they were trying to get a right to foreclose, so I think we will have plenty of money there to take care of it.

Mr. Harpole: There have been a good many oil reserve cases tried in the courts and sometimes the estimates prove [8] out and sometimes they do not but it is almost invariably true as years go by less and less oil can be taken from the wells.

The Referee: But the land alone for harbor purposes is worth considerably over \$200,000.

Mr. Lynch: And this is true, one of the cases where estimates of the oil income were made by Mr. Carey when this field was first opened up was actually below what has been produced.

The Referee: I feel that everybody is going to be protected there and there is no use of letting the money lay in the bank. If necessary the Court could bring on a sale of the oil properties and oil lands and certainly it will bring more than enough to pay any tax claim.

Mr. Harpole: The tax claims themselves draw interest at six per cent.

The Referee: I know.

Mr. Lynch: May it be stipulated—

The Referee: I think I will grant the petition.

Mr. Lynch: May it be stipulated, Mr. Harpole, if Mr. Metcalf were called he would testify in accordance with the petition? There has been no answer filed so I assume you would stipulate?

Mr. Harpole: It is a verified petition?

Mr. Lynch: Yes.

Mr. Harpole: I will stipulate Mr. Metcalf would testify [9] as he set out in the petition. without waiving any objections that some of the things set out are conclusions of law and not statements of fact.

The Referee: You also concede if he was here he would testify as related by Mr. Lynch as to the additional accumulations in the fund since the petition was filed?

Mr. Lynch: In other words, there is about \$5200 more than has been received from the oil royalties since this petition was filed.

Mr. Harpole: I would so stipulate.

Mr. Lynch: And it is referred to as being the approximate amount in the petition.

The Referee: Very well. You may draw the order as indicated.

Mr. Lynch: Yes, your Honor, thank you. [10]

In the District Court of the United States
Southern District of California
Central Division

Before Hon. Ernest R. Utley—Referee.

State of California
County of Los Angeles—ss.

I, C. N. Olson, official reporter of the above-entitled court, do hereby certify that the foregoing pages 1 to 10, both inclusive, comprise a full, true and correct transcript of the proceedings in re: Order to Show Cause, Trustee versus United States of America and Security-First National Bank of Los Angeles of October 5, 1944.

Dated this 6th day of February, 1945.

C. N. OLSON

Official Reporter

[Endorsed]: Filed Feb. 6, 1945 at 30 min. past 2 o'clock P. M. Ernest R. Utley, Referee. B. Clerk.

[Endorsed]: Filed Feb. 10, 1945. [11]

[Title of District Court and Cause.]

Before the Honorable Claude McColloch

REPORTER'S TRANSCRIPT OF PROCEEDINGS
ON HEARING OF PETITION FOR REVIEW
OF REFEREE'S ORDER OF OCTOBER 17,
1944 [1]

Los Angeles, California, Monday, February 26, 1945.

2:30 P. M.

Mr. Harpole: I assume that your Honor has had an opportunity to examine the order?

The Court: I have looked through the file, but I can't say I understand it.

Mr. Harpole: That perhaps is not strange for the reason that there have been, you might say, other chapters to this same litigation that somewhat tie in. We just came from Judge McCormick's court room, where the matter of fixing a bond on appeal from an order directing payment of the 1938-1939 income taxes was taken up. The income taxes for this year have been adjudicated. The Ninth Circuit has allowed them, and they have been held to be an expense of administration by the District Court, in the petition that was brought subsequent to the action of the Ninth Circuit Court for an order directing the Trustee to pay the taxes that had not been paid.

After that had occurred, the Trustee in Bankruptcy asked leave to pay certain interest to the Security-First National Bank, and that's the substance of the petition from which this review came. In the proceeding he mentioned not only the fact that certain taxes had been adjudicated, but the record bears out that the government

had a claim for income taxes for the same years subsequent to 1939, in the amount of about \$35,000. That claim had neither been [2] objected to nor actually allowed. It was simply a claim on file. The tax, if it were due, was income tax arising from the profitable operation of the business or property of the bankrupt by the Trustee,—money made in the course of bankruptcy.

In addition to that the Trustee was aware of some negotiations that he had had for years, that were not then under assessment, bringing the respective taxes and interest unpaid up to about \$100,000, all of it covering the years in which the property or business of the bankrupt was operated by the Trustee.

At the time the petition was filed the bankrupt owed the First National Bank a great deal of money on a secured loan, and interest was running on the unpaid balance of that loan. The Trustee sought, and was granted permission to pay about \$5,000 interest—between five and six thousand dollars; the exact amount of which appears in the record. There was about \$40,000 or \$45,000 of money in the estate at that time, and there was a great deal of real property, most of it encumbered.

The review was filed to the referee's order, directing the payment of \$5,000 interest, and the reason for the review, as set forth in the memorandum, was that these income taxes are an expense of administration, and it is the position of the government that the interest upon any secured debt is still only a debt; it is an accretion to the debt. [3] and consequently, under the provisions of the Bankruptcy Act, particularly found in 11 U. S. Code, 104 (a) (b), those taxes should be paid before the debts of the bankrupt are paid. The alternative might be, if the bank succeeded in establishing that the \$5,000 was an

expense of administration rather than a part of the original debt, then a prorated payment should be made; the bank's \$5,000 ought to stand against the total of the tax due to the government on the ratio of about 5 to 100, on a prorated basis.

That is the reason of the review, and I think I have nothing to add to what has been cited in the memorandum of points and authorities.

The Court: I will ask some questions after I have heard everybody.

Mr. Lynch: I think possibly in view of the court's observation it might be helpful if we gave a little more of the factual background.

The background and history of the case, as Mr. Harpole has given it, has not been entirely factually correct. The record will disclose, and I may say the contract I am about to refer to is a part of the record in this proceeding by reference—the record discloses that prior to January 12, 1937, the F. P. Newport Corporation was indebted to the Security-First National Bank in excess of \$1,300,000. That indebtedness was secured by a trust through the Security-First National Bank, under the terms and provisions of which [4] the bank held the record legal title to approximately 90 per cent of all the property of this corporation, as security for that particular indebtedness. Prior to January 12, 1937, the bank had instituted foreclosure proceedings. Upon the filing of the petition in bankruptcy in this case the bank was restrained from proceeding with these foreclosure proceedings and, after considerable discussion and negotiations between the interested parties, we made a contract between the bank, the bankrupt corporation, and the Trustee in Bankruptcy.

and that is the contract that has been referred to as the contract of January 12, 1937.

Under this contract the fact that the bank held this property as security for this indebtedness was recognized. It was agreed that that indebtedness was a certain stipulated amount, and the contract provided that the Trustee in Bankruptcy should pay interest on that indebtedness at the rate of four per cent per annum, the interest to be paid quarterly. It also provided, in the performance of the obligations undertaken by the contract, in addition to paying the indebtedness, the entire indebtedness was to be paid in instalments over a period of years, and if there was default in the payment of that indebtedness the bank might then go ahead and foreclose, and no defense would be made to an application on their part to foreclose, after the expiration of 60 days' notice.

An appeal was taken from the order approving the [5] contract, by certain creditors. It went to the Circuit Court of Appeals, and was approved. A petition for certiorari was filed with the Supreme Court, and denied. So that contract has the blessing of this court and the Appellate Court for the Ninth Circuit.

So one of the direct obligations undertaken by the Trustee, pursuant to the approval of the Bankruptcy Court, was that he should pay the Security-First National Bank interest at four per cent on the unpaid principal, that payment to be made quarterly. That was one of the things that motivated the bank to enter into the contract—the realization that they would get their interest paid during the period this property was being held by the Trustee, and eventually liquidated. In other words, the motivating cause of this contract was the belief of the bankrupt and the creditors, if they were given time, this property could

be liquidated for sufficient to pay not only the bank but also the secured creditors, in an amount of some \$200,000.

A fortunate thing occurred; we struck oil on part of this property, a nine-acre tract; we have six oil wells. Those wells are now producing approximately between \$5,000 and \$6,000 a month royalties net to the estate. The contract which was entered into between the bank, which I referred to, the contract of January 12, in addition to other things, provided that the revenue from the oil wells should be placed in a special account, and that money so deposited [6] was to be available to the Trustee for the purpose of paying taxes, interest on the indebtedness, and other expenses therein itemized.

The bank has always insisted that the funds from this account were subject to the trust originally, and by the terms of the contract made subject to the lien of the bank, and as security for the payment of their indebtedness. The government took the position that its income tax, which was the tax resulting from the production of this oil, was an expense of administration, and that they were entitled to have their income tax paid out of that oil fund, out of the oil royalties which we have deposited in a special account. The court determined that the government was correct in that conclusion, and there is now on appeal to the District Court of Appeal the question of whether or not the determination of this court is correct in that regard.

The Court: You are appealing?

Mr. Lynch: No, the bank is appealing from the order, contending that they have a prior lien on all of these funds and that they cannot be used for the purpose of paying taxes. There is a provision, incidentally, in the contract that expenses of administration are not to be paid out of

these funds. However, the bank did, by the contract, expressly provide that interest on the obligation to the bank could be paid out of these funds.

It is the position of the Trustee in Bankruptcy that the [7] interest accruing on this debt subsequent to adjudication is an expense of administration. The contract to pay this interest is the contract of the Trustee in Bankruptcy made by and with the approval of the Bankruptcy Court. Therefore, it is an expense of administration. It is, in our opinion, certainly every bit as much an expense of administration as the income tax assessed by the government.

There was an obligation entered into in good faith, with the approval of the Bankruptcy Court, so we feel it definitely is an expense of administration. The only taxes that have been adjudicated, that is, the only income taxes that have been adjudicated in this case as being expenses of administration and entitled to be paid out of these funds, are taxes for 1938-1939, which in principal amount to a little over \$19,000, and with accumulated accrued interest, approximately \$25,000. It is true there is in the offing additional taxes, but they have not yet been passed on and determined by the court to be expenses of administration.

The Court: Why not?

Mr. Lynch: The matter has just never been presented, is about the only answer I can make to that.

We don't believe, I will say very frankly, that the estate has any objection to approximately \$35,000 of additional taxes, but still that question has not yet been determined, and the Bankruptcy Act provides expenses of administration can only be allowed by the court, must be approved by [8] the court, and that has not been done, in addition to the income taxes of \$25,000. Right now in

this special oil fund we have in the First National Bank—I am going outside of the record when I say there is approximately \$56,000.

Mr. Harpole: I don't believe you are. I think the record shows that.

Mr. Lynch: There is right now approximately \$56,000 in that account. At the time that this was heard there was \$46,000, and additional income has been received, amounting to approximately \$5,000 a month income, less the real property taxes which have been paid, so that fund is steadily growing. We have enough on hand to pay this allowed and determined claim of the government of \$19,000 plus interest, and if it is subsequently adjudicated to be payable—in other words, there is an appeal from that right now, and there is enough to pay that and pay the interest to the Security-First National Bank.

So it is our position that we should go ahead and pay it; that the Referee may be given an order directing him to pay it. I would think that order justified, because we think it is an item of expense. There are enough funds on hand to pay that and to pay this \$25,000, if it is ultimately determined the government is entitled to receive it, and give us something more. By the time this order is passed on we will have additional funds, and as the Referee in Bankruptcy pointed out in the transcript before the court, [9] there is sufficient value to the real properties in this estate to pay off the government, if eventually it is determined the government is entitled to receive payment.

So, in any event, it is our position that the government will not be prejudiced by the payment of this particular item of interest, and if we don't pay it we very frankly face this situation, for the bank to come in this court and say: This contract, which was made with the ap-

proval of the court, provides we are to receive our interest at the rate of four per cent, payable in quarterly instalments; in other words, if it isn't paid we are entitled to foreclose, and no defense will be made to that foreclosure. That is our position, and the whole value of the estate may be lost to everybody—not only the government, but to the creditors, and everybody else.

The Court: You ought to get that interest rate reduced.

Mr. Lynch: We got it reduced from seven to four per cent.

Mr. Shelton: It was first eight; then six, and then four. This matter has been pending, your Honor, since it was put in its present form in 1936.

Mr. Lynch: The bankruptcy proceeding started March, 1935. Actually we paid the bank all but approximately \$450,000 of over \$1,300,000, and we have been paying interest all along until just recently, and the government gets apprehensive [10] all of a sudden that they are not going to get theirs out of it, so they have taken a review of this particular order. But we have been paying it pursuant to the court's order, in instalments, ever since 1937. I will say, frankly, in my opinion the two items are expenses of administration. I am not going to say what my view may be, as to whether the government is entitled to any income tax, but the court so far has held that they are, so, assuming that that is correct, the two items are expenses of administration.

If we had a limited fund, with no possibility of its growing, they would have to be paid pro rata, and a payment of \$5,000 interest would be out of proportion, but, so far as the immediate matters before this court are concerned, we do have enough money to pay this tax, and we have enough money to pay this instalment of in-

terest. Frankly, I think when it comes time to pay the other—when and if the government finally gets an order that they are entitled to it, we will have enough to pay it.

Mr. Shelton: There is very little, your Honor, I can add to what has been said. We feel this fund which we are fighting over is a sequestered fund for the payment of this debt; that is what the contract says, but until the Ninth Circuit has an opportunity of ruling whether the government has a priority over the payment to the bank—until that is ruled on, we can't argue the matter. We are convinced that what the attorney for the Trustee says is correct. I can't [11] imagine how the government is going to suffer by this, because all parties conceded in this proceeding from time to time that the oil properties are producing—I think the estimate of \$5,000 is a little high; I think it is about \$4,500 a month.

Mr. Lynch: I said it was between \$4,000 and \$5,000.

Mr. Shelton: It has a tendency to drop off; not very substantially. This appeal has been taken by them, and I can't see how the United States Government is possibly going to be hurt in the slightest by this payment.

The Court: If I allow the payment Mr. Harpole is going to appeal it.

Mr. Shelton: I don't know. He didn't appeal the other one.

Mr. Harpole: That's true, your Honor; there have been some orders not objected to. It is obvious that more than a half million dollars have been paid to the bank on this debt. The government hasn't been paid anything yet. It was the belief on the part of the people in charge of the estate here until very recently that they did not owe any tax; that a tax could not be collected from them.

Mr. Lynch: We still have that belief.

Mr. Harpole: The Treasury Department at least was not a party to the contract. They did not agree to subordinate themselves to the bank. They had no part in making the agreement of 1937. It as simply accepted by the revenue [12] officers for what it said, and the courts have said, when a trustee in bankruptcy, operating the property of the bankrupt, realizes a gain, he is subject to income tax. That was the holding of the Ninth Circuit. The petitions in this case and the briefs suggest this, that the bank may be on the verge of foreclosing this property. Suppose it is allowed to foreclose and take away the land, and perhaps the money owed for the tax is not paid—I suppose it can't take away all the money at this time, because there was just an order directed in the course of preparation, sequestering enough to pay the adjudicated taxes; the bank gets four per cent interest, and the income tax carries six per cent, so there is a two per cent advantage in favor of the estate if the tax is paid.

The Court: How can a foreclosure be averted if the bank insists on its rights under the contract?

Mr. Harpole: It would have to be denied by the court.

The Court: The unpaid balance of the principal is past due?

Mr. Harpole: It has been for a great while.

Mr. Lynch: When the order was last made enjoining foreclosure until next June, all the interest had been paid currently. There was no unpaid interest then involved. That order expressly provided if there were any change in circumstances it was without prejudice for the bank to come back and renew its application to foreclose. We are [13] apprehensive, if the bank is not paid its interest, it will say: Here is the contract. You agreed we were to get our interest. It is one thing to say we can't realize

our principal right now, but it is another to say we can't have interest due on our money.

Mr. Harpole: This comes down to a very narrow legal point: Must the expenses of administration be paid before the debts due the estate? If that be the case, there has been more than a half a million dollars paid on this debt, and there hasn't been anything paid on income taxes, which are expenses of administration. If they are both expenses of administration, it would seem at least they ought to prorate. One person ought not to receive the administration expense, and another in the same class receive nothing.

The Court: Do I understand there is enough on hand to pay interest, and pay the adjudicated tax claim?

Mr. Harpole: No, there isn't in cash.

Mr. Lynch: Yes, there is, Mr. Harpole. The court asked you about the adjudicated tax.

Mr. Harpole: For the adjudicated tax, yes, there is enough to cover that, but there is another tax of \$35,000 which the reporter's transcript indicates the Trustee is not going to contest, and that is the prima facie tax. That is also due, until it is overruled.

The Court: Has a claim been filed?

Mr. Harpole: A claim has been filed. [14]

Mr. Lynch: That isn't true in bankruptcy. That is the ordinary taxpayer's position, that when a claim has been filed there is a presumption of validity of the claim. The Bankruptcy Act expressly provides any expenses of administration must be submitted under oath and passed upon and approved or disapproved by the court. That has never been done with reference to any of this tax, with the exception of this one adjudicated claim. I cite the section of the Bankruptcy Act in my memorandum. I don't remember the section.

Mr. Harpole: That loses sight though of the revenue statutes, I think. There are specific statutes on these taxes, and they say that the Trustee in Bankruptcy—Section 142 of the Internal Revenue Code—shall be subject to all of the laws that apply to individuals, and one of those laws is that tax be paid on notice and demand. The demand has been made and presented in the usual form. It is true the Trustee can object to it, but he has indicated he does not intend to, unless he has changed his mind.

Mr. Shelton: I have heard, however, the attorney for the bankrupt, who takes a pretty active part in all these proceedings, stated he would contest the payment of further income taxes. A great deal of the \$35,000 is predicated on the sale of real estate on a profitable basis, so, irrespective of what the Trustee in Bankruptcy might do, there is a contest coming up on the assessability of the tax [15] against the bankrupt's estate.

I was not in that fight against the levy of the assessment of taxes. I am sympathetic, of course, in the view of the Trustee. I thought his brief covered the subject; but this I do know, since we are talking about what the Ninth Circuit may or may not do, the Ninth Circuit has said in a recent case if the Trustee in Bankruptcy elects to conduct a business on behalf of the bankrupt, any obligation which he assumes in the way of taxes must be paid by him, and not out of the secured creditors. Mr. Harpole speaks about being a creditor. We are no unsecured creditor in this matter. We are in the position of an adjudicated secured holder of the legal title to this property which the Circuit Court of Appeals has held is in the nature of a deed of trust, with a lien expressly impressed upon all rents, issues, profits and royalties. That was the original declaration, and the contract supplement-

ing that, referred to by the attorney of the Trustee in Bankruptcy, says expressly that all of the income from this property is impressed with a lien, and that it shall be segregated from all general funds of the bankrupt estate, and shall be earmarked for the payment of this debt, and shall be held for the purpose of immediately paying off in full the bank,—as clear a sequestration contract, at least in our opinion, as could be drawn. That matter goes on up.

I was thinking about the citation of authorities from [16] the Ninth Circuit. The Trustee in Bankruptcy does not have to go ahead and operate any business. That is his gamble. He can't do it at the expense of a secured creditor.

The Court: Whose brain child was the contract?

Mr. Shelton: Mr. Lynch and I are the parties who drew up the contract.

The Court: Was any reference made to taxes in the contract?

Mr. Shelton: Yes, there was a reference made to taxes, but not quite so broad as my associate has referred to. It referred to the fact that this general fund would be available for taxes which were a charge against the estate and to the trusteeship of the bank. The bank is trustee in that matter. The only taxes assessable against them were on real estate. It was conceded by all parties that was what was incorporated in that contract. It referred to taxes sustained by the trustee of the bank; not the Trustee in Bankruptcy.

The Court: Was the discovery of oil contemplated?

Mr. Shelton: The discovery of oil was contemplated in that the contract provided it should be put in a special fund and earmarked, and payable on this debt in full, except that it should be used in the payment of such taxes

as might be due. At that time, I am very frank to say, I don't think the parties to the contract, who drafted the contract, [17] had any idea that the Trustee in Bankruptcy liquidating an estate of this kind could ever, under the facts of the case, be held to the operation of the property or business of the company. I think it is an unfortunate decision, but it is there.

Mr. Lynch: I would say that determination of the Circuit Court of Appeals that the Trustee had to pay an income tax was a pioneer decision. It is the only decision in the country holding the Trustee liable for the payment of income tax on the production of oil, where that production of oil was carried on through the management of the lease to a third party. In other words, it is the position of the Trustee that the production of the oil was nothing but a liquidation. It has established some law; that is all.

The Court: Were there contrary decisions?

Mr. Lynch: No; it has never been passed on.

The Court: Was certiorari denied?

Mr. Lynch: Yes, certiorari was denied, so we are faced with the proposition that the court has adjudicated that there is an income tax payable, but now the question up on appeal is the question as to whether that income tax could be paid out of these funds that are claimed by the bank. That has not yet been determined by the Circuit Court, this matter now being on appeal, and, of course, if the bank should succeed in its appeal in this matter, and it is determined that income taxes are not payable out of the oil [18] revenue then, of course, the government is going to have to wait along with the rest of the unsecured creditors until the bank is liquidated.

The Court: Are all these questions you gentlemen have discussed covered in the memorandum on file?

Mr. Harpole: The priority payment between the debt and expenses of administration is discussed in the government's memorandum, and that is the only question discussed in our memorandum.

Mr. Lynch: It is discussed in our memorandum, too. I will say frankly we did not go into as much history of this case as I would be inclined to do now because I realize your Honor is not so familiar with it as Judge McCormick, who has lived with this case since 1937 but he seems to be getting a little tired of it.

Mr. Shelton: 1935—he has lived with it 10 years.

Mr. Lynch: Yes. I would be very happy to supplement it, if the court wishes any additional information.

Mr. Shelton: The bank has filed no brief, but adopts the one filed by Mr. Lynch as presenting our position.

The Court: I would like to have Mr. Dewing strike off what has been said. I think there have been some questions discussed here that are not discussed in the memoranda.

Mr. Lynch: The estate and the government I am sure will agree to that.

Mr. Harpole: Yes, I think the court should have a copy [19] of the transcript.

The Court: You are just talking about the 1938 and 1939 taxes?

Mr. Harpole: No, the 1938-1939 taxes have been adjudicated. The non-adjudicated taxes would run, I believe, from 1940 to 1943 inclusive, and possibly some for 1944. Mr. Lynch is more familiar with that than I, because there are some taxes he mentioned in his petition in the hearing before the Referee that had not been reduced to a claim.

The Court: When was oil struck?

Mr. Lynch: In 1938. The government has filed claims for some forty-odd thousand dollars, in addition to the 1938-1939 tax, of which they have admitted there was an erroneous assessment of \$12,000, so it reduces the claim which they have filed to around \$35,000. That includes the years 1940, 1941 and 1942, and no audit has been made for 1943 and 1944. There is a possibility there will be some tax for 1943, but our present belief is there will be none for 1944.

The Court: It looks like, though, this is a kind of situation which will never catch up with itself. You have an income of fifty or sixty thousand dollars a year from the wells, and your interest is \$20,000 a year to the Security-First National, and the suggestion in the brief is that the government claims an interest in half of the oil royalties for taxes. [20]

Mr. Lynch: That is not wholly correct, because even on the basis of the claims that have been filed for 1940, 1941 and 1942, taking into consideration the erroneous assessment they already admit, the tax liability for those years, assuming there is a tax at all, is approximately \$35,000 for the three years, and yet for those three years our oil income was approximately—those years it was greater—the oil income was in excess of \$250,000, for those three years. For 1944, for instance, our income has been something over \$60,000 from the oil, and yet I don't think we will have any tax at all. I will say, in explanation of that, the government has taken the position so far that the Trustee in this particular estate is liable for tax on gain on the sale of real property. Consequently, if the estate gains on the sale of real property, the estate is entitled to a credit for losses for 1944 on the sale of real property to offset the oil income, so apparently they are not going to have any tax.

The Court: It seems to me, deciding this immediate question on the narrow basis—it wouldn't call for a decision on the underlying legal question—I could say, assuming all that Mr. Harpole is urging in view of the financial setup he is not going to be hurt.

Mr. Lynch: That is our position.

The Court: That is one of your positions. Mr. Harpole doesn't want me to do it that way. He doesn't agree with me [21] that a question like this should be decided on that kind of a basis. He says the government—I may be putting words in his mouth, but I have heard ardent representatives like him speak for the government about taxes before, so I am sure I do not exactly say he was thinking the government should ever be put in any jeopardy of its position, and that it should be paid first for what has been immediately adjudicated, and then reserves should be maintained for its possible claims.

That is what I mean when I say, from the government's point of view, accepting the government's point of view in full, the situation never would catch up. With their immediate claims and their fears, which always total more than there is on hand, there would not ever be enough left, if this interest payment were made every year, to make them absolutely sure of their position. He is not going to want me to decide it that way. If I say: Here, Mr. Shelton, you take this \$5,000 until the date of your next quarterly payment. You would have to go to Judge McCormick, and Mr. Harpole would be there urging the same things; and if I put it on that narrow ground I wouldn't be deciding anything except immediate pay-

ment of the \$5,000. If I were to go ahead and hold against Mr. Harpole on his legal position, and hold with Mr. Lynch and Mr. Shelton on their legal position, on your next quarterly payment you would come in and say to Judge McCormick: By comity you have got [22] a decision we ask you to follow. If Mr. Harpole had not appealed the thing would be settled, and this threat of foreclosure would be averted permanently.

That is the practical aspect of this situation which I must first resolve. I could go out, take figures, repeat what I have just said, and probably come back here and do what you immediately want me to do. Whether that is the approach I should make, I want to think about that. As I said a moment ago, Mr. Harpole is going to appeal, regardless of what ground I put it on. The government always does. If I should hold against you, you would have to ask authority, wouldn't you?

Mr. Harpole: That isn't always the case, your Honor. I might recommend against the appeal, but the decision would be made by the Solicitor General.

The Court: In other words, you are not prepared to say as to that?

Mr. Harpole: No, I never am. I never know until I get the information.

Mr. Lynch: I am frank to say if I thought there were not going to be sufficient funds on hand to pay both in full I would not want to pay any one of them to the prejudice of the other; but I very definitely believe the government would not in any way be prejudiced by our payment of this claim in full, because it is my conviction

that there will be sufficient funds on hand to pay all of them, assuming it [23] is eventually held the government is entitled to be paid out of this fund at all.

The Court: One of my difficulties, too, gentlemen, is that I have only hold of a part of the problem. It would have been better for one of the local resident judges to have dealt with this, when you consider there is involved in my decision on this the foreclosure question. If I should deny Mr. Shelton money he feels he is entitled to, and he feels it strongly, that is apparent, three weeks from now, when I have left town, he is going to be before another judge here asking for a foreclosure, quite likely, and if he is a good man for his client, he no doubt would. I would feel pretty strongly too, if I had drawn up a contract and the situation had turned up as it has, that I would have to back up my ante; so I will think about it a little more for those reasons. It is not a thing I feel I should attempt to decide right now. I will ask the reporter to run these notes off, and if there is anything more occurs to you, considering the other demands on your time, which you would like me to have, I will welcome any further suggestions.

Mr. Lynch: With the court's permission, I think I will talk to the clerk, and see if there is available that contract.

The Court: Isn't it set forth in the file?

Mr. Lynch: No, it is not. There have been so many reviews of this matter, and the contract is so long, we have just referred to it by reference. The contract is on file in the clerk's office.

[Endorsed]: Filed Mar. 9, 1945. [24]

[Endorsed]: No. 11059. United States Circuit Court of Appeals for the Ninth Circuit. United States of America, Appellant, vs. H. F. Metcalf, as Trustee in Bankruptcy of the Estate of F. P. Newport Corporation, Ltd., a corporation, Bankrupt, and Security-First National Bank of Los Angeles, Appellees. Transcript of Record. Upon Appeal From the District Court of the United States for the Southern District of California, Central Division.

Filed May 14, 1945.

PAUL P. O'BRIEN,

Clerk of the United States Circuit Court of Appeals for the Ninth Circuit.

In the United States Circuit Court of Appeals
for the Ninth Circuit

No. 11059 .

UNITED STATES OF AMERICA,

Appellant,

- v -

SECURITY-FIRST NATIONAL BANK OF LOS
ANGELES, and H. F. METCALF, TRUSTEE IN
BANKRUPTCY OF F. P. NEWPORT CORPORA-
TION, LTD, a corporation.

Appellees.

STATEMENT OF POINTS RELIED UPON
ON APPEAL

The appellant states that it intends to rely in its appeals from the Orders of the United States District Court, dated March 6th and April 13, 1945, upon the points mentioned

in the Statement of Points relied upon by appellant, found at pages 36 and 37 of the record in said appeal.

Dated: this 9th day of May, 1945.

CHARLES H. CARR, United States Attorney
E. H. MITCHELL, Asst. U. S. Attorney
GEORGE M. BRYANT, Asst. U. S. Attorney
EUGENE HARPOLE, Special Attorney

Bureau of Internal Revenue

By Eugene Harpole

Attorneys for Appellant.

Received a copy of the within Statement of Points Relied Upon on Appeal this 17 day of May, 1945. W. C. Shelton & George W. Burch, Jr., by E. J. Lincoln, Attorneys for Appellees, Security-First National Bank of Los Angeles. Bailie, Turner & Lake, by Allen T. Lynch, Attorneys for Appellee, H. F. Metcalf, Trustee in Bankruptcy.

[Endorsed]: Filed May 18, 1945. Paul P. O'Brien, Clerk.

[Title of Circuit Court of Appeals and Cause.]

STIPULATION FOR CONSOLIDATION OF APPEALS FROM THE ORDERS OF THE DISTRICT COURT OF MARCH 6th AND APRIL 13, 1945.

It is hereby stipulated and agreed by and between counsel for the appellant and the appellees, subject to the approval of the Court, that the Appeal of the United States from the Order of the District Court of March 6, 1945, may be consolidated with its Appeal from the Order of

the District Court of April 9, 1945, and that said appeals when so consolidated may be further consolidated with the Appeal of the Security-First National Bank of Los Angeles from the Order of the United States District Court of February 6, 1945, and that the record on appeal of said Security-First National Bank may be used in connection with and as a supplement to the record in the Appeal of the United States from the said Orders of the District Court of March 6th and April 9, 1945.

Dated: this 9th day of May, 1945.

CHARLES H. CARR, United States Attorney
E. H. MITCHELL, Asst. U. S. Attorney
GEORGE M. BRYANT, Asst. U. S. Attorney
EUGENE HARPOLE, Special Attorney,

Bureau of Internal Revenue

By Eugene Harpole

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Attorneys for Appellees, Security-First
National Bank of Los Angeles

BAILIE, TURNER & LAKE

By Allen T. Lynch

Attorneys for Appellee, H. F. Metcalf,
Trustee in Bankruptcy.

It Is So Ordered this 18th day of May 1945.

FRANCIS P. GARRECHT

Circuit Judge

[Endorsed]: Filed May 18, 1945. Paul P. O'Brien,
Clerk.

